because of the ulcer he is unable to pursue his regular vocation or employment. Ohio is thus placed definitely in the majority liberal group. In fact, the specific nature of the test would indicate that its position in the group is well toward the front. H. D. R.

NEGOTIABLE INSTRUMENTS

NEGOTIABLE INSTRUMENTS — EFFECT OF HIGHER INTEREST RATE AFTER MATURITY — CONTRACT FOR LIQUIDATED DAMAGES OR PENALTY — EFFECT UPON NEGOTIABILITY

The defendants executed a promissory note to a bank, for which the plaintiff was receiver, for $7000 due in one year, with interest at six per cent per annum. In addition, it contained a provision that the note should draw interest at eight per cent per annum after maturity to be computed and paid semi-annually until the principal and accrued interest were paid. In a suit on the note to recover eight per cent, the Court of Appeals held that where money is paid by the borrower to the lender for the use of money after it is past due it is regarded as liquidated damages, and that the parties may stipulate in the lending contract for a rate of interest after maturity higher than the rate before, but it must not exceed the maximum rate prescribed by the usuary statute.[1]

This exact situation seems to be a case of first impression in Ohio. However, there are two earlier cases somewhat related which furnish an interesting comparison. In addition, a question arises as to the court's interpretation of sec. 8303 Ohio G.C., that is, does this section expressly authorize a stipulation for a higher interest rate after maturity than before?

"In Ohio, the agreement is legal, expressly made so by statute (sec. 8303 G.C.)"[2] With those words, the court in the principal case accepts

[1] *Hackett* v. *Kripke et al*, 62 Ohio App. 89, 23 N.E. (2d) 438 (1939). In the principal case the provision in the note that it was to be eight per cent per annum "payable semi-annually" was not discussed. A question arises as to whether or not this is usurious under Section 8303 which provides that the interest must "not exceed eight per cent per annum, payable annually." In *Cook* v. *Courtright*, 40 Ohio St. 248 (1883), the court held that a stipulation that the interest was to be eight per cent per annum payable semi-annually was not usurious under Section 8303. The court held that a contract to pay eight per cent per annum on a given principal payable semi-annually, the interest to be paid on that principal, is the same thing as eight per cent per annum payable annually upon the same principal. However, under the same statute, if the interest is at eight per cent per annum payable annually in advance, it is usurious. Thus, if a note is for $12,000 at eight per cent per annum payable in advance and if the interest is deducted from the principal before giving it to the borrower, the borrower pays eight and sixty-eight one hundredths per cent on the amount actually received for his use. *Insurance Co.* v. *Carpenter*, 40 Ohio St. 260 (1883). It is interesting to note that these two cases were decided during the same term.

[2] *Supra* note 1.

the proposition that a higher rate of interest after maturity than before maturity is a valid stipulation. A question arises as to whether or not sec. 8303 expressly authorizes a higher rate of interest after maturity, since the statute does not refer to it in any manner. The section in question says that the parties may stipulate for the payment of interest not exceeding eight per cent per annum.[3] It does not expressly mention rates either before or after maturity, and thus, if the higher rate is to be authorized by the statute it would seem that it must be done by implication rather than by an express statement.

However, it would seem reasonable that such an implication may be drawn. In Ohio, the parties have a right to stipulate for any interest rate within the limits of sec. 8303 and the rate of interest so contracted for will be enforced.[4] After maturity, if no interest rate has been stipulated, the interest rate before maturity will continue as the interest rate for the period of the default.[5] From the fact that parties may under this section contract for any rate of interest before maturity and that rate will continue after maturity if no other rate is stipulated, it would seem that the parties could contract for a higher rate after maturity than they had contracted to pay before maturity, providing, however, that it remains within the eight per cent per annum maximum. Especially is this true in view of the attitude the Ohio court has taken where there was no interest rate before maturity, but an interest rate after maturity, the court holding that the note was a good contract and that the interest could be collected.[6]

The first of the two cases mentioned for comparison is *Askren* v. *Longworth*.[7] In that case, a note for $1000 was given subject to yearly interest, but, if each payment was made on or before due date only $800 and yearly interest would be required. The obligor paid $800 but not as required and then asked that his note be given up and cancelled. The court held that the larger sum was in the nature of a penalty and payment of the less discharged the obligation. Two possible distinctions immediately arise, they are: (1) in the *Askren* case, the provision was not for interest but for a fixed sum, while in the principal case it was for

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[3] Section 8303 Ohio G.C. provides: "The parties to a bond, bill, promissory note, or other instrument of writing for the forbearance or payment of money at a future time, may stipulate therein for the payment of interest upon the amount thereof a any rate not exceeding eight per cent per annum, payable annually."

[4] *Bunn* v. *Kinney*, 15 Ohio St. 40 (1864); *Marietta Iron Works* v. *Lottimer*, 25 Ohio St. 621 (1874); *Mueller* v. *McGregor*, 28 Ohio St. 265 (1876); *McClelland* v. *Sorter*, 39 Ohio St. 12 (1883).

[5] *Monnett* v. *Sturges*, 25 Ohio St. 384 (1874); *Marietta Iron Works* v. *Lottimer*, *supra* note 4; *Mueller* v. *McGregor*, *supra* note 4.

[6] *Bowler* v. *Houston*, 1 Ohio Dec. Rep. 389 (1851).

[7] 15 Ohio St. 370 (1864).

interest; (2) the *Askren* case would allow a deduction for compliance, while the principal case permits a higher rate on default. As to the first distinction, interest may readily be reduced to a sum and a sum may readily be reduced to interest by a simple mathematical calculation. As to the second distinction, Judge White says that whether the amount is to be reduced by compliance, or increased on default, it is simply a mode of expressing the same thing.[8] A third distinction, however, clearly separates the *Askren* case and the principal case. It is the obvious distinction between a slightly higher rate of interest if the note is not paid and a $200 increase if the debtor delays a single day. The latter, it would seem, has no relation to the loss or damage suffered, but is a penalty for missing the payment.

The second case is *Miller* v. *Kyle*.[9] In that case, the note contained a stipulation for the payment of attorney fees if the note was not paid at maturity; the court held that provision void as being against public policy in that law suits would thereby be encouraged. The *Miller* case and the principal case may be distinguished, first, on the ground that a stipulation for attorney fees is not the same as a higher interest rate after maturity; second, on the ground that there is no public policy involved in the principal case. However distinguishable, there is a similarity among the decisions regarding a stipulation for attorney fees and a stipulation for a higher rate of interest after maturity. Some of the decisions hold that the parties have a right to contract for the payment of attorney fees as long as no law is violated, thus, the stipulation is valid.[10] The same theory supports the decisions sustaining the validity of a higher interest rate after maturity.[11] On the other hand, other courts have held that a stipulation for attorney fees is void as against public policy, either because it is usurious [12] or because it is a penalty.[13] While the decisions denying the validity of a higher interest rate after maturity do not say the provision is against public policy they do regard it as a penalty and void.[14]

In other jurisdictions where the question has been adjudicated, the majority of the courts hold that a stipulation in an interest bearing note

[8] *Supra* note 7, at page 375.

[9] 85 Ohio St. 186, 97 N.E. 372 (1911).

[10] *Commercial Investment Trust* v. *Eskew*, 126 Misc. 114, 212 N.Y. Supp. 718 (1925); *Rubenstein* v. *Nourse*, 70 F. (2d) 482 (Mo. 1934); *Colley* v. *Summers Parrott Hardware Co.*, 119 Va. 439, 89 S.E. 906, Ann. Cas. 1917D, 375 (1916).

[11] *Infra* notes 15, 16, 17.

[12] *Ohio* v. *Taylor*, 10 Ohio 378 (1841).

[13] *Miller* v. *Kyle*, *supra* note 9; *First National Bank of Holly Grove* v. *Sudbury*, 121 Ark. 59, 180 S.W. 470 (1915).

[14] *Infra* note 18.

that it shall bear a higher but lawful rate after maturity is a valid stipulation.[15] The theory of these courts is that the parties are free to contract as they please for interest as long as the rate is lawful. Thus, in *Linton* v. *National Life Insurance Co.*,[16] the court held that a rate of ten per cent was lawful and the makers of the notes had a right to agree to pay a higher rate after maturity than they had contracted to pay before maturity. In *Red Bank Realty Co.* v. *South*,[17] the court said that "so long as the parties contract for a rate of interest that does not exceed the maximum rate allowed by law, their contracts will be enforced as written." And in the same case it was held that such contractual increase in rate after maturity is regarded as liquidated damages for failure to pay promptly and not as a penalty. Thus, the holding of the principal case is in line with the majority of the cases.

The minority on the other hand regard the higher rate of interest after maturity as a penalty and void.[18] In Minnesota, the courts have regarded a higher rate after maturity as invalid, and the leading case prior to the present statute held that the parties couldn't stipulate as to interest after maturity at all.[19] However, the statute[20] now provides that a contract shall bear the same rate after maturity as it did before maturity, hence, a higher rate is void. In Illinois, on the other hand, such an increase in interest after maturity has been regarded as a penalty but nevertheless enforced.[21]

A question arises as to the effect of the decisions in regard to higher interest stipulations after maturity on the negotiability of the note. The first possibility would be to hold the stipulation void and the note non-negotiable. In *Cornish* v. *Woolverton*,[22] the Montana court held the instrument non-negotiable, saying that the note is for an uncertain sum. However, in *Lister* v. *Dolan*[23] this same court held that the provision for a higher rate was for a sum certain and that the instrument was negotiable. The second possibility would be to hold the stipulation void

[15] "The validity of a stipulation in an interest bearing note that it shall bear a higher but lawful rate after maturity is sustained by the majority of judicial decisions." 12 A.L.R. 369, with annotations. See also, *McKay's Estate* v. *Belknap Savings Bank*, 27 Colo. 50, 59 Pac. 745 (1899); *Finger* v. *McCaughey*, 114 Cal. 64, 45 Pac. 1004 (1896); *Jackson* v. *Fennimore*, 104 Okla. 134, 230 Pac. 689 (1924).

[16] 104 Fed. 584 (1900).

[17] 153 Ark. 380, 241 S.W. 21 (1922).

[18] *Mason* v. *Callender*, 2 Minn. 350, 2 Gil. 302, 72 Am. Dec. 102 (1858); *Conrad* v. *Gibbon*, 29 Iowa 120 (1870); *Waller* v. *Long*, 6 Munf. (20 Va.) 71 (1818).

[19] *Mason* v. *Callender*, *supra* note 18.

[20] Mason's Minn. St. (1927) Sec. 7036. For a decision under this statute see *Investor's Syndicate* v. *Baskerville Bro's Holding Co.*, 200 Minn. 461, 274 N.W. 627 (1937).

[21] *Bradford and Son* v. *Hoiles*, 66 Ill. 517 (1875); *Laird* v. *Warren*, 92 Ill. 204 (1879); *Hennessey* v. *Walsh*, 142 Ill. App. 237 (1908).

[22] 32 Mont. 456, 81 Pac. 4, 108 Am. St. Rep. 598 (1905).

[23] 85 Mont. 571, 281 Pac. 348, 72 A.L.R. 1 (1929).

and the note negotiable. In Minnesota, the higher rate is void because of a statute;[24] however, the courts have not allowed that to interfere with the negotiability of the instrument.[25] In *Miller* v. *Kyle*,[26] the Ohio court held that although the stipulation for the payment of attorney fees was void, the instrument was none the less negotiable. The third possibility would be to say that the stipulation is valid and the note is negotiable. As has been said, the great weight of authority considers this type of interest provision as valid.[27] It is also true that the great weight of authority holds that this type of interest provision does not destroy the negotiability of the instrument.[28] In *National Life Insurance Co.* v. *Silver*,[29] the Oklahoma court held that such a provision was a valid contract as long as it did not contravene the usuary law, and in *Moore* v. *Interstate Mortgage Trust Co.*,[30] the same court held that the provision did not destroy negotiability. F. A. R.

USURY — APPLICABILITY OF OHIO G.C. SEC. 6346-5A TO CREDIT UNIONS

The plaintiff, a credit union organized under Ohio G.C. sec. 9676 *et seq.*, sued on a note for the sum of $823.04, with interest at the rate of one per cent per month on the unpaid balance. The defendant pleaded in avoidance that the plaintiff was subject to Ohio G.C. sec. 6346-5a, which provides that a licensee under the Small Loan Company Act[1] shall not charge any interest on loans in excess of $300.00 at a rate greater than eight per cent per annum, under penalty of forfeiture of the right to collect either principal or interest. It was held that the note was void as violating this statute.[2]

The decision was unsatisfactory for a number of reasons. In the first place, there was no mention of the Credit Union Act,[3] by virtue of which the plaintiff is engaged in the loan business. Section 9683 pro-

[24] *Supra* note 20.

[25] *Investor's Syndicate* v. *Baskerville Bro's Holding Co., supra* note 20.

[26] 85 Ohio St. 186 (1911).

[27] *Supra* note 15.

[28] "The same rule is applied where a note bearing interest is to bear a higher rate from maturity if not paid; such a promise in a note does not, according to the weight of authority render it non-negotiable." 2 A.L.R. 140. See annotations in 2 A.L.R. 140 and 41 A.L.R. 294. In addition, see *Burns Mortgage Co., Inc.* v. *Friedman*, 292 U.S. 487, 78 L. Ed. 1380, 54 Sup. Ct. 813 (1934).

[29] 65 Okla. 85, 163 Pac. 274 (1916).

[30] 172 Okla. 471, 45 P. (2d) 485 (1935).

[1] Ohio G.C., sec. 6346-1 *et seq.*

[2] *Columbus Postal Employees Credit Union, Inc.* v. *Mitchell*, 62 Ohio App. 343, 23 N.E. (2d) 989 (1939).

[3] Ohio G.C., sec. 9676 *et seq.*